Financing Options for Large Water Projects

Arizona Water Resources Development Commission

Finance Committee Meeting

February 3, 2011

Yavapai Regional Capital, Inc.

Prescott, AZ and Washington, DC

Yavapai Regional Capital

- Arizona-based holding company
- True old-style merchant bank
- Regional footprint in the U.S. Mountain States
- Focused on essential infrastructure *new* builds
- Boots-on-the-ground; we're at the *"coal face"* ensuring quality control and origination
- The best *"sniff test"* in the business

Our goal is to empower public officials

YRC Core Skill Sets

- Old-fashioned Project Finance
- Public policy relationship development – officials, engineers, city councils
- Public buy-in
- Team management
- Superior due diligence

Finance alone doesn't make good deals

Traditional U.S. Financing

- **Municipal bond financing** for all infrastructure types
  - U.S. mainstay over last ten years.
  - Approximately $2.4 trillion outstanding.
  - Based on ability to tax.
- **U.S.G. financing & state supplements** (e.g., WIFA)
- **But:**
  - Muni-bond market in disarray due to overleveraging.
  - State & U.S. budgets very tight + taxes can't be raised.
  - Maintenance and replacement needs never fully met.

This situation likely to not change in our lifetime

Foreign Infrastructure Financing

- **Central government funds** for a long time
  - But in the 1970's, they began to run out of money.
- **Project Finance**
  - Debt from private sources – mainly European.
  - Equity from various equity funds, now some pension funds.
  - Based fundamentally on cash flows of "ring-fenced" projects.
- **Rapidly increasing demand worldwide:** Asia, Middle East, Latin America, Africa, Europe.
- **Solid Bank Assets:** PF loans—excellent asset class; loss rates below corporate borrowings.

Project Finance + Public role = Public Private Partnerships

PPP Definition

Outsourcing Infrastructure Projects with Shared Roles

PPP – A Contractual Partnership

Legally specified responsibilities and sharing of risk, generally over 20-50 years, for projects >$50 million

Private Sector Roles

- **Project feasibility**
- **Private capital (construction and L-T debt, plus equity)**
- **Cutting-edge technology**
- **Construction efficiency**
- **Operational innovation**

Public Sector Roles

- **Definition of output needs**
- **Specifications**
- **Oversight & regulation**
- **Rights of way / Zoning**
- **Local knowledge**
- **Seed capital ($/land/equip/people)**

This format maximizes the strengths of each partner.

Financing Required for a PPP

Equity & debt): $1-2mm for concept development including studies, initial due diligence, early organization of key players

Debt: 50%-90% of project cost for 4-5 years
Equity: 10%-50% of project cost ("normal" is 20%)

Debt: 50% - 90% of project cost for 20-40 years

Development Capital → **Construction Debt & Equity** → **Long-Term Post-Completion Debt**

Development Capital

- States/Counties
- Cities/Towns
- Econ. Develop. Commissions
- National Infrastructure Bank
- Private Sector Developers
- Private Sector Investors
- **Specialized PPP Development Fund**

Construction Debt & Equity

Debt

- Commercial Banks
- National Infrastructure Bank
- Infrastructure Debt Funds

Equity

- Infrastructure Equity Funds
- Pension Funds
- Insurance Companies

Long-Term Post-Completion Debt

- Insurance Companies
- Pension Funds
- Municipal bonds
- REITs

Project Finance Lenders

Project Finance ranking 2008 --- Source: Reuters Project Finance International					
Rank	Bank	Nationality	Loan Volume ($ billions)	% Market Share	No. of Deals
1	RBS *(exited late 2008)*	British	$13,195	5.3	86
2	BNP Paribas	French	$11,926	4.8	81
3	State Bank of India	Indian	$11,512	4.6	25
4	SMBC	Japanese	$10,297	4.1	71
5	Calyon	French	$9,911	4.0	70
6	Dexia	French	$8,823	3.5	89
7	Mitsubishi UFJ	Japanese	$7,973	3.2	58
8	WestLB	German	$6,943	2.8	43
9	ING	Dutch	$6,576	2.6	62
35	Goldman Sachs	US	$2,169	0.9	3

Note that U.S. banks are minority players, if at all

Equity Providers

- **Global:** U.S., Canada, Middle East, Europe, and Asia.
- **Infrastructure funds:** Vast amounts of money flowed into these.
- **Pension funds:** Now opening to project finance.

Primary hurdle: lack of carefully-evaluated projects that can't be developed from Wall St.

PPP Advantages

- **Financial Cost:** Tax-exempt & Private Finance debt/equity costs usually a wash **after tax.**
- **Savings**: Up to 40% construction savings available based on power sector and CBO for water.
- **Efficiency:** No change orders for public officials = more rapid completion.
- **Timeliness:** Projects built all at once rather than in pieces, which saves money and provides jobs TODAY.

Lower construction costs translate into lower user charges = value for money

Keys to Successful PPPs

- **Entrepreneurial cities & states:** No dinosaurs.
- **Economics:** Projects make economic sense.
- **Engineers:** Good engineering first.
- **Due diligence:** Uncovering risk is priority #1.
- **Financial structure:** Balance returns & leverage.
- **Public Buy-In:** Build grass-roots from day 1.

Ultimately, U.S. banks have to get back into financing infrastructure projects

Our Preferred Water Model

Traditional U.S. Water Model

Electors ← Public Agency

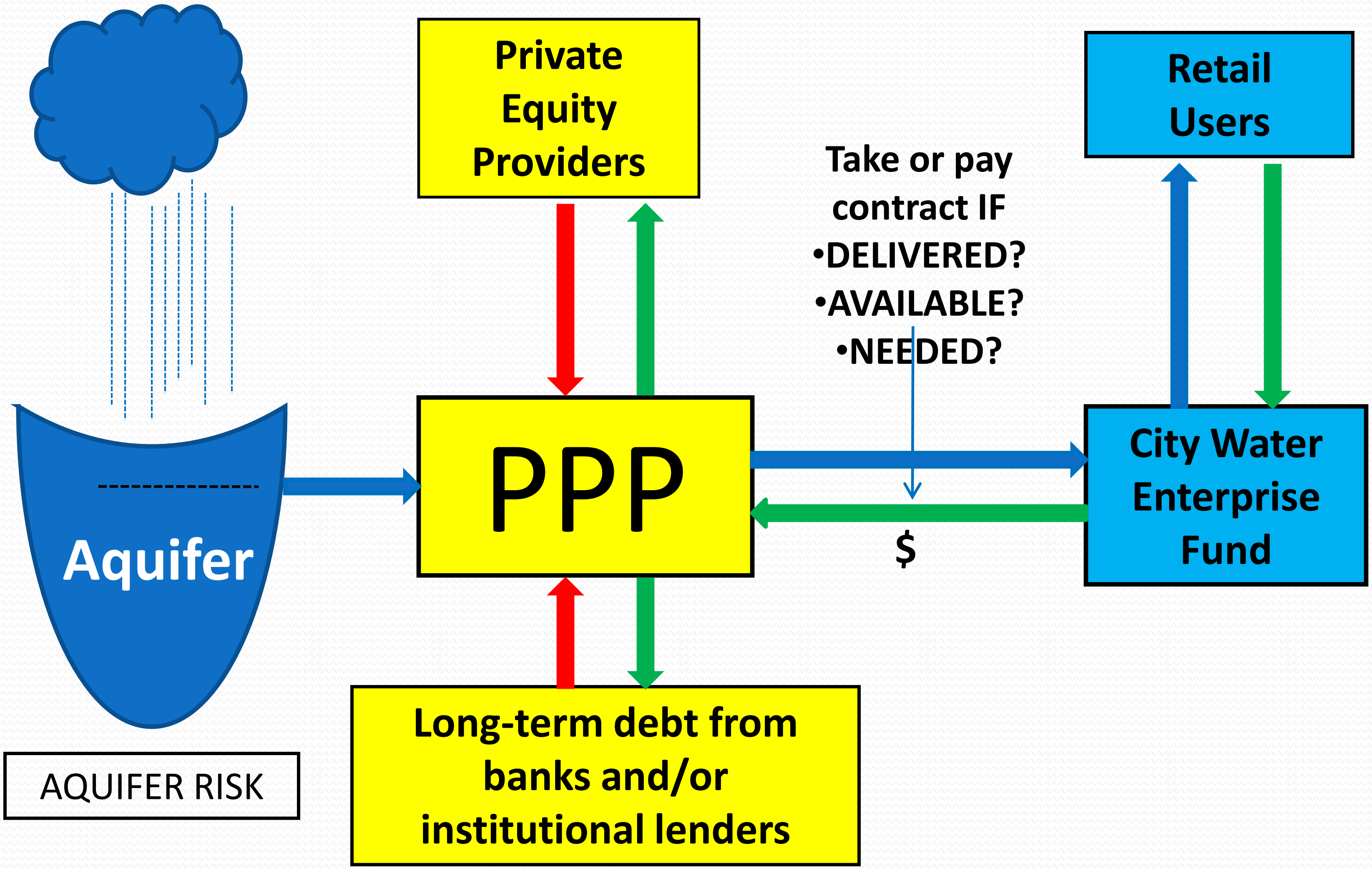
OR

Investor owned utility [Cost plus] → ACC

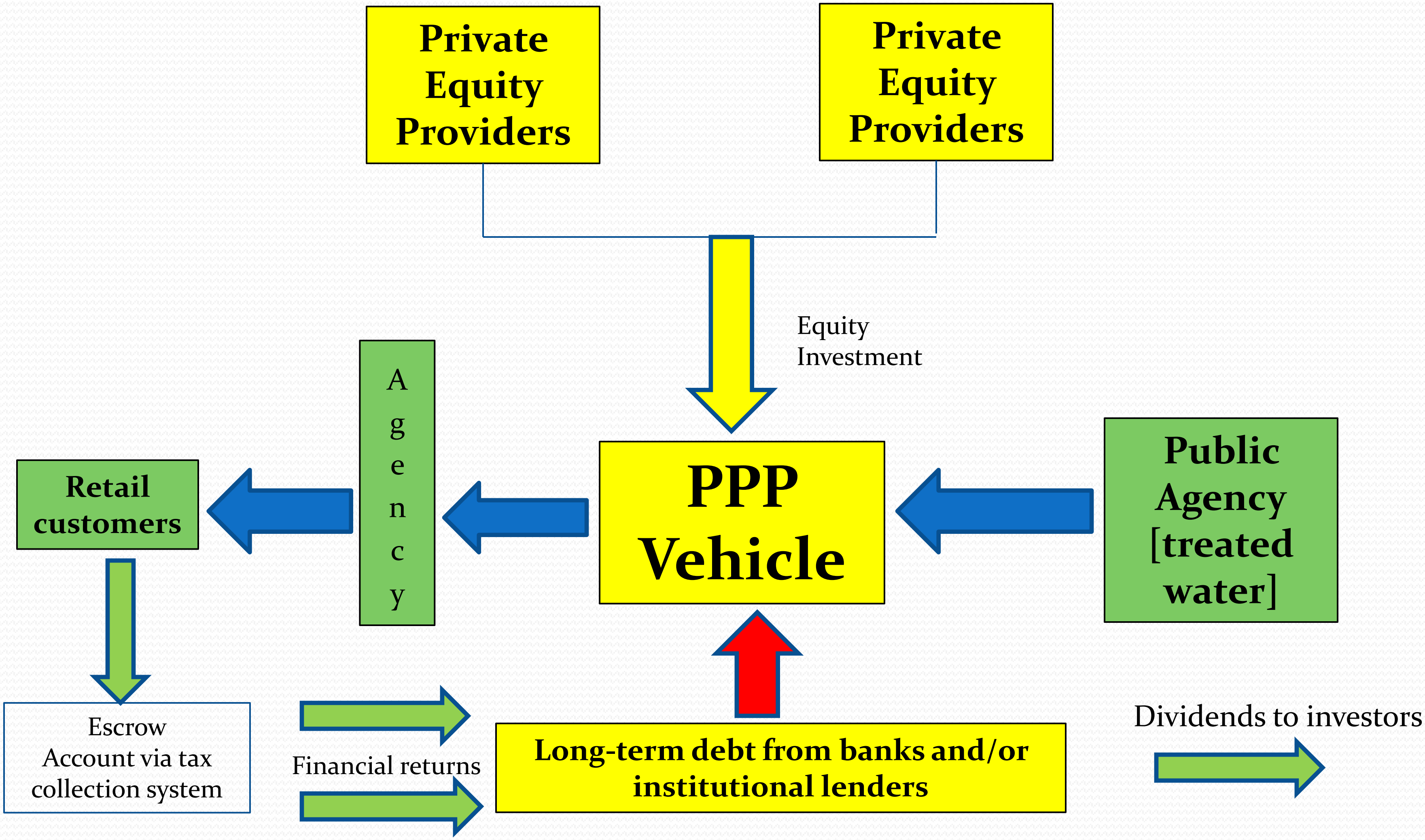
True Public Private Partnership – not Privatization

Electors ← Public Agency ← Contract → Design, Build, Finance & Operate Vehicle

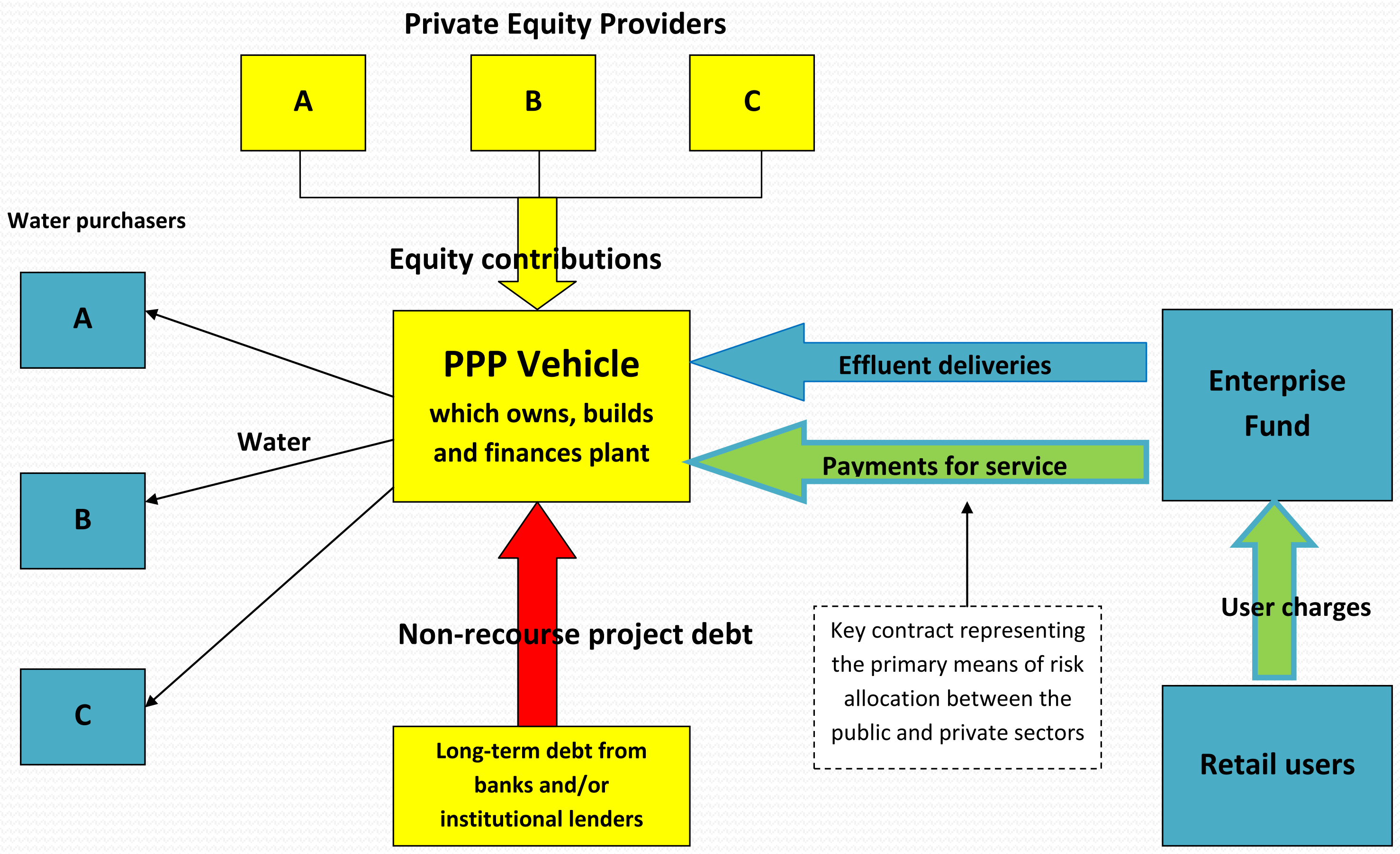
An Aquifer or River Source



Pure Distribution Network



A Treatment or Processing Plant



Interaction with BoR Process

Public Sector

BRM Study Period → Congressional Long-Term Funding

Co-development Funding

Development Capital → Construction Debt & Equity → Long-Term Post-Completion Debt

Private Sector

and the winner is?